

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	No. 06-0741
Atmos Energy Corporation	:	
	:	
Reconciliation of revenues collected under	:	
gas adjustment charges with actual costs	:	
prudently incurred.	:	

**REPLY BRIEF OF STAFF OF THE
ILLINOIS COMMERCE COMMISSION**

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NOW COMES Staff (“Staff”) of the Illinois Commerce Commission (“Commission”), by and through its undersigned counsel, pursuant to Section 200.800 of the Commission’s Rules of Practice (83 Ill. Adm. Code 200.800), and respectfully submits its Reply Brief in the instant proceeding.

I. INTRODUCTION

Staff’s Initial Brief (“IB”) was filed and served on Atmos Energy Corporation (“Atmos” or “Company”) on June 7, 2012. Some issues have been resolved between the Atmos and Staff as indicated in Staff’s Initial Brief. Staff’s Initial Brief gave a summary of these resolved issues and they will not be repeated here. Aside from issues addressed in this Reply Brief, Staff stands by its positions articulated in its Initial Brief. Staff’s arguments in response to the Company’s Initial Brief are set forth below. Failure to address a specific issue in this Reply Brief does not constitute a change of position

from Staff's Initial Brief. For the reasons stated below, Staff's recommendations should be adopted by the Commission.

II. CONTESTED ISSUES

A. Applicable Legal Standard

Staff and Atmos both agree on the applicable legal standard, which is

In accordance with Section 9-220 of the Act, the Commission may authorize an increase or decrease in rates and charges based upon changes in the cost of purchased gas through the application of a purchased gas adjustment clause. Section 9-220(a) requires the Commission to initiate annual public hearings "to determine whether the clauses reflect actual costs of . . . gas . . . purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual cost of . . . gas . . . prudently purchased." In each such proceeding, the burden of proof is on the utility to establish the prudence of its applicable costs.

Both the Commission and the Illinois Appellate Courts have defined prudence as the standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. In determining whether a decision was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible in the context of a prudence determination.

(See Atmos IB, pp. 5-6 (internal citations omitted); see *also* Staff IB, p. 4)

Despite both parties agreeing that a prudence review prohibits hindsight review and only those facts available at the time judgment was exercised can be considered, Atmos insists upon using hindsight and facts not available to it at the time it exercised judgment to justify the alleged prudence of its actions. (See Atmos IB, p. 16 "The prudence of this decision was borne out through examination of the pricing paid by Comparable Utilities.") (See also Atmos IB, pp. 27-30) Atmos cloaks this tactic in a variety of robes, but it still attempts to use the Comparable Utility data to bolster the prudence of its decision making.

For example, Atmos throws out the red-herring that Staff relied on “Comparable Utility data in the 2005 PGA” and, thus, it must be useful and relevant. (Atmos IB, p. 27) First, this argument is intended to distract the focus from Atmos and instead shine the light on Staff. Atmos, however, is the utility, not Staff. Atmos carries the burden of proof, not Staff. Atmos is subject to a prudency review, not Staff. Atmos is precluded from using hindsight to bolster its prudency position.

Further, despite Atmos’ argument to the contrary, Staff did not rely on Comparable Utility data in the 2005 PGA to support a position that Atmos had not been prudent in its decision making. Staff merely noted that no other comparable utility had an adder the size of the Atmos adder and Atmos provided **NO** rational reason why it needed such a large adder. (Docket No. 05-0738, Staff Exhibit 2.0, p. 35) Staff discussed the Comparable Utility data and merely noted that up to that early point in the docket, in a drawn out proceeding with multiple rounds of testimony, Staff made a quick comparison to comparable utilities, and raised questions about the size of the Atmos adder. It should be noted that the 2005 PGA never went to an evidentiary hearing, let alone any briefing. Accordingly, Atmos’ contention in this proceeding that Staff “relied” on Comparable Utility data in the 2005 PGA (Atmos IB, p. 27) is misleading.

B. Gas Supply Contracts

1. Prudence Review

Atmos defends its 2005 and 2006 contracts as prudent by concluding that AEM was the low bidder on both Requests for Proposals (“RFPs”). (Atmos IB, p. 8) However, Staff’s arguments do not hinge on whether Atmos followed its bidding procedures. Staff has pointed out that RFPs and their evaluation cannot change the competitive state of

the market that the RFPs seek to tap. Atmos limited the 'market' by its actions in the years previous to 2005 and 2006. If the 'market' is not competitive, the bidding procedure cannot rescue it from the possibility that the winning bid is imprudent. Atmos stripped the transportation and storage assets from the Harrisburg-Galatia territory. (Staff IB, p. 8) Atmos was then obliged to buy its gas from suppliers that had the capacity available on TETCO, (*Id.*, p. 9) a pipeline with limited total capacity.¹ (*Id.*, p. 7) Certainly, interest in the contract remained low during the period during which AEM won the contract. (Staff IB, p. 11)

Atmos argues, "...Staff witness Rearden has generally agreed that no evidence of a causal relationship between the previous decade's capacity release and a price change had been demonstrated." (Atmos IB, p. 25) Yet, in his rebuttal testimony, Staff witness Rearden concluded, "Both events [low numbers of bids and the imposition of a high adder] comport with my opinion that the lack of transportation capacity and failing to increase the pool of potential bidders led to vulnerability to a high bid." (Staff Ex. 4.0, p. 8)

One reason that there might have been so few bids was that the Company used an opt-in procedure rather an opt-out procedure. Atmos obfuscates the issue in its IB, when it states, "Staff witness Rearden appears to be operating under a mistaken assumption that Atmos removed entities from its RFP mailing list for not bidding in one year." (Atmos IB, p. 20) Dr. Rearden averred only that the letter accompanying the RFP stated that suppliers must positively confirm they wished to receive an RFP the

¹ That TETCO had limited total capacity available is important, since Atmos is not able to acquire firm transportation capacity on TETCO from other subscribers. Thus, Atmos was restricted to seeking bids from marketers with access to a limited resource.

following year or they would not receive an RFP the following year. (Staff Ex. 3.0, p. 7) In Dr. Rearden's view, the opt-in procedure unnecessarily limited the pool of bidders. (*Id.*) Further, suppliers may have been discouraged by AEM repeatedly winning the bid.

Atmos dismisses this contention, arguing that there is no direct correlation between the greater number of RFPs and the price of the gas in the bids it would have received. (Atmos IB, p. 21) However, Dr. Rearden never postulated a simple relationship between the number of RFPs and the number of bids or the price in the bids. His discussion was predicated upon averages and probabilities. However, he did reasonably conclude that more RFPs would have led to at least as many bids, at little cost to Atmos. Thus, the decision to force suppliers to opt-in likely discouraged bidders and so unnecessarily raised gas costs. (Staff Ex. 4.0, pp. 8-9)

On the other hand, Atmos could have issued more RFPs, in order to increase the likelihood that more bids would be returned, and in turn, to raise the probability that more bids would lead to a lower price. In contrast, Staff notes that the imprudently high adder in the 2005 contract was arrived at via a single-bid RFP, and remained the same in the 2006 contract. (Staff IB, p. 6) It can be noted that the 2006 contract could be interpreted as a single-bid contract as well, since one of the three bids was rejected, (Atmos IB, p. 9) while the other bid did not technically conform to the RFP but was evaluated. (*Id.*)

Atmos explained the increase in the price for Harrisburg supply by appealing to the market fluctuations caused by the two hurricanes. (Atmos IB, p. 14) Atmos' sole supplier to the Harrisburg territory from November 2003 through October 2008 was its wholly owned affiliate, AEM. (Staff IB, p. 6) After Hurricanes Katrina and Rita hit the Gulf

Coast, AEM, as the sole bidder for the 2005 contract, increased its bid from index flat to index plus a very high adder. (*Id.*) It appears that the effects of the hurricanes were static and long-lasting since, two years later, AEM bid the SAME Adder for the SAME supply, and it remained the lowest bid. (*Id.*)

Atmos argues that it is unreasonable to suggest that gas utilities are always able to buy gas at index flat. The reasons, it argues are that, "...index adders are commonplace in the gas marketplace and further noted it is necessary to take into account the basis differential when determining whether a particular index pricing is reasonable." (Atmos IB, p. 15) Staff never implied that index flat pricing was guaranteed for any utility, but it did point out that Atmos bought gas at ETX flat in 2003 and 2004. (Staff IB, p. 6) AEM could have earned the same margins in 2005 and 2006 that it did in the first two years of the contracts by buying at the ETX index price and shipping to Harrisburg. It should be noted that the gas costs assessed under every AEM contract for Harrisburg included demand and variable transportation charges. (*Id.*, pp. 5-6)

Atmos argues that Commission precedent indicates that only that portion of costs that are imprudent should be disallowed. (Atmos IB, p. 18) Staff determined that the ETX index flat served as a reasonable counterfactual price, especially given the few objective alternatives. (Staff IB, p. 16) Atmos argues that Dr. Rearden was incorrect when he argued that no other index or adder was available to provide an alternative disallowance. (Atmos IB, p. 18) However, the argument to support this claim is tautological. Atmos states, "The fair market price is established by the market composed of willing buyers and sellers." (*Id.*, p. 19) As noted above, the market, in Staff's view, was not competitive due to Atmos' actions. If the monopoly price that

Atmos accepted from AEM is too high, then that price cannot be used as an alternative price. If the price accepted is not imprudently high, there is no requirement for an alternative price.

Atmos argues that it was not necessarily imprudent to abandon and transfer its transportation leases, because delivered citygate service can be a prudent decision. Atmos states, "Since neither delivered service or transport capacity is clearly better, the Company's (or more particularly, its predecessor's) decision to rely on delivered service cannot be found imprudent..." (Atmos IB, p. 23) Field purchases transported to the citygate may not always lead to lower cost gas than delivered service. However, Staff emphasized that the comparison is usually made for utilities with well-developed markets. This is very important, since a utility such as The Peoples Gas Light and Coke Company can readily purchase gas in liquid markets at the citygate. Access to a liquid market means that citygate gas purchases are a realistic alternative to field purchases within a portfolio that includes both types of purchases. (Staff IB, p. 12)

Atmos further defends its unapproved capacity releases by claiming large savings on demand charges for its ratepayers. It states in its IB, "Staff witness Rearden does not really dispute that the Company did in fact save money over time, although he does point out that it is difficult to ascertain the amounts with a good degree of certainty." (Atmos IB, pp. 22-23) Of course, when Dr. Rearden disputed the certainty of the savings to ratepayers, he was arguing that the savings might in fact be zero. (Staff IB, pp. 13-14)

With respect to the peaking service, the Company's IB states, "[T]he Company had a reasonable basis for believing bundling the system requirements would result in a

lower overall price.” (Atmos IB, p. 32) However, Atmos’ proposition remains untested, and it is unclear what prevented Atmos from bidding out the service separately. (Staff IB, p. 18) The Company also states, “In Docket No. 94-0040, the Commission held that only a portion of cost in excess of the amount deemed prudent should be disallowed, rather than disallowing all costs.” (Atmos IB, p. 18) However, given the paucity of available information concerning the value of a service that is difficult to evaluate absent market information, Dr. Rearden did not speculate on its value in his analysis of the peaking service. It was nearly impossible to set a value on the peaking service apart from the rest of the 2005 and 2006 contracts. (Staff IB, p. 17) It should be noted that the demand charge for the service that was available for only ten days was priced the same as full baseload service. (*Id.*, pp. 17-18)

III. CONCLUSION

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission’s order in this proceeding reflect all of Staff’s recommendations.

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Respectfully submitted,

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